

AR49

Equitable Securities Canada Limited

*Member: The Toronto Stock Exchange
Investment Dealers' Association of Canada*

Head Office: 110 Yonge Street, Toronto 1

Telephone: 366-1141

Telex: 02-2297

— • —

Other Offices:

Montreal—Place Ville Marie.

Telephone: 866-3701

Edmonton—300 Empire Building.

Telephone: 429-1262 and
424-3298.

U.S. Subsidiary:

Equitable Canada Incorporated
68 William Street
New York 10005

Investment Letter

— • —

**OCTOBER
1970**

— • —

Equitable Securities Canada Limited

*Member: The Toronto Stock Exchange
Investment Dealers' Association of Canada*

110 YONGE STREET, TORONTO 1

Telephone: 366-1141

Telex: 02-2297

SCOTT'S RESTAURANTS CO. LIMITED

Selected Statistical Data

Current Price:	\$8.75					
Latest e.p.s.:	\$0.51					
P/E:	17.2	Per Share		Sales	Operating	Net
Yield	Nil	Earnings	Dividends	(\$000)	Income	Income
					(\$000)	(\$000)
Range:	1970: \$11¾ - 6	\$0.38¾	Nil	\$18,811	\$2,793	\$1,337
	1969: * 11¾ - 6⅞	0.24½	—	11,883	1,602	763
	1968: —	—	—	9,295	962	477
	1967: —	—	—	6,863	510	255
	1966: —	—	—	5,181	433	242
	1965: —	—	—			

*Listed Oct. 9, 1969

OPINION

We think Scott's is an excellent vehicle for the investor looking for a growth situation. To date Scott's has been very successful in not only penetrating and increasing its share of the highly competitive food service industry but it has had an extraordinary growth in earnings as well. Testimony to this is the consistent record of sales increases which have been accompanied over the last four years by the upward movement of the profit margin ratio.

In order to continue the growth, new outlets must continually be opened and while the working capital remains in a deficit position, the Company states that profits generated from cash sales of approximately \$2 million per month will be sufficient for its normal operations and current expansion programme. Thus, the Company with an excellent main product, the Colonel Sanders Kentucky Fried Chicken, and obviously shrewd management, continues to be one of the better growth situations available today. We believe that investors not dependent on dividend income who accumulate the shares now will be well rewarded for their foresight.

THE COMPANY

Scott's Restaurants Co. Limited is the result of an amalgamation during the summer of 1968 of Scott's Restaurants Limited and Scott's Catering Limited. Since 1937, Scott's Restaurants Limited, had been actively engaged in the food business and for some period thereafter had served the Toronto and Ottawa area with a chain of restaurants catering to men only under the name "Bowles Lunch". Following World War II, the Company expanded and branched out into more diversified areas of the retail food business taking advantage of the changing eating habits which had made "eating out" more fashionable.

The expansion of its restaurant operations followed Scott's entry into the industrial catering business in 1952. Colonel Sanders Kentucky Fried Chicken sales outlets were opened in 1962 to be followed the next year with the opening of the Company's first Highway Service Centre. In 1968 the Company's capital and corporate structure was reorganized to consolidate its various operations and on October 9, 1969, the common shares were listed for trading on the Toronto Stock Exchange.

OPERATIONS

The business of the Company can be divided into three main divisions: Scott's Chicken Villa, serving the Colonel Sanders Kentucky Fried Chicken, The Restaurant & Highway Service Centre operations and Industrial Catering.

Scott's Chicken Villa—Scott's has an exclusive 24-year agreement with Col. Sanders Kentucky Fried Chicken Ltd. in the preparation and sale of chicken. They are allowed to use the name, autograph, portrait, photograph and other likeness of Colonel Harland Sanders and the phrases "Kentucky Fried Chicken", "Colonel Sanders' Recipe", "It's Finger Lickin' Good", "North America's Hospitality Dish" and other related phrases. The agreement covers the areas of Metropolitan Toronto, Metropolitan Ottawa, Peterborough, Windsor, Chatham, Brantford and London, and the Province of Quebec with the exception of the City of Quebec and six isolated franchises. The take out operation operates under the name of "Scott's Chicken Villa" in the Province of Ontario and as "La Ville du Poulet" in the Province of Quebec and, at present, there are a total of 93 Take Out Shops in operation and other outlets are under construction and on the planning board.

Restaurant and Highway Service Center Operations—The Company operates five restaurants in Metropolitan Toronto and one in downtown Ottawa with seating capacities varying from 50 to 160 people. Four are licensed for the sale of alcoholic beverages, two feature the sale of Kentucky Fried Chicken and two of the Toronto locations also have banquet facilities available for 50 to 175 people. For those locations that do not warrant the capital cost of a full scale restaurant operation, "Take Five Shops" have been opened with satisfactory results. Seven Highway Outlets have been opened along the 401 (in conjunction with Texaco Canada Limited and one with Supertest) and one has been established on the Trans-Canada Highway at Perth, Ont.

Industrial Catering—A variety of food catering services to industrial and large office buildings are provided by Scott's and it presently operates in 20 various Metropolitan Toronto areas. Scott's also owns and places food and beverage vending machines in Toronto and Ottawa and has over 100 such machines in operation. Mobile coffee wagon services are provided in several large buildings in Toronto.

TECHNICAL

A total of 900,000 shares were originally offered to the public at \$6.00 per share in September of 1969 and they traded for a short time on the unlisted market before 4,158,260 shares were listed for trading on the Toronto Stock Exchange (stock symbol SRC) on October 9, 1969. Owing to the short trading history, it is perhaps too early to expound on the technical aspect of the shares however, looking at the market action over the last year would reveal the following. A strong demand accompanied by good volume carried the price of the shares in the first two months from about \$7 to \$11¾. Resistance was met at this point and they traded for the next few months in the \$11 to \$11¾ range. In May, 1970, a poor overall equity market (and perhaps some profit taking) resulted in the shares weakening in price and returning on low volume to their original \$6.00 offering price. Consistent earning increases and a better market tone finally led to renewed investment interest and the shares have exhibited strength during the past five months and now appear capable of breaking through their previous high of \$11¾ recorded at the beginning of this year.

FINANCIAL

Years Ended Dec. 31:	1965	1966	1967	1968	1969
Operating Margin*—%	8.4	7.4	10.4	13.5	14.9
Net Profit Margin—%	4.7	3.7	5.1	6.4	7.1
Return on					
Common Equity—%			N/A		18.3
Total Assets**—o/s			N/A		28.7

*After cost of sales, operating and administrative expenses.

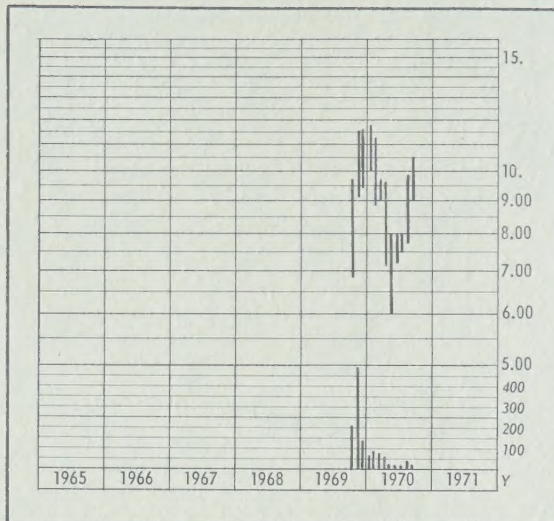
**Profit before taxes.

***O/S as at Dec. 31, 1969—4,108,260 common shares.

Whether measured by sales or earnings, the Company reflects an outstanding Canadian merchandising success. Sales have tripled and earnings grown over five fold in the 1965-69 period. Of course, this exceptional record cannot be continued indefinitely. However, judging from the Company's present expansion progress and future plans, we estimate at least a 50 per cent earnings improvement this year, and a less spectacular but still splendid 20-25 per cent increase for 1971. The latest available interim report for the 28 weeks ended July 12, 1970 shows sales of \$14.6 million, up 72.6 per cent over the comparable 1969 period and after tax profits at \$1.1 million—up 98.8 per cent.

Scott's expansion has been financed internally whenever possible. Accordingly, there is no long term debt to speak of, but dividends have had to be postponed to enable the Company to maintain a satisfactory cash balance. In view of the substantial cash flow, and the speed with which inventories can be transformed into cash, the Company's present financial position appears satisfactory. From a profit standpoint, the limited issuance of new shares for acquisitions should appeal to the growth conscious investor.

SCOTT'S RESTAURANTS CO. LIMITED



Condensed Balance Sheet as at Dec. 31:

Assets	1968	1969
Current	\$ 563,773	\$2,735,163
Fixed	1,693,098	5,265,189
Other	26,242	1,944,806
	\$2,283,113	\$9,945,158
Liabilities		
Current	\$1,549,796	\$2,356,649
Other	—	293,148
Sh. Equity***	733,317	7,295,361
	\$2,283,113	\$9,945,158

SUMMARY

The Kentucky Fried Chicken operations have been the main contributor to the Company's record of growth. The area in Canada in which they have the exclusive rights to develop this facet of their operations represents approximately 50% of the Canadian market in terms of potential customers. An extensive advertising and promotion program keeps their products in front of the public and they also benefit from the movement of visitors from the United States who encounter a familiar food product. Scott's serves the area of Canada with the highest density of population and, its locations along the highly travelled 401 and Trans-Canada Highway can expect to benefit from increased movement along these routes. As for the Davey Jones Fish & Chips operation, still in its infancy, the concept is attractive and a satisfactory profit is anticipated by the Company.

The strong growth aspect of its operations have thus far been reflected in earnings and the most recent figures for the 28 weeks ended July 12, 1970 (sales up 72.6%, profits increased by 98.8%) all indicate that the outlook is one of continued growth in both sales and profits and, accordingly, the shares are attractive as a vehicle to participate in this future.

MARKET COMMENT

Industrial share prices in the American and Canadian markets, as measured by the popular indices, have rallied approximately 20% from the lows established late in May. Western Oils, of course, have attracted more than their share of the spotlight in the Canadian market with that index now at a level roughly 75% above the May lows. In view of the extent of the rally we would like to see the market settle back at this point and consolidate the gains. Certainly if the advance carries too much further over the nearer term there will be a real possibility, in view of the indifferent outlook for profits in the months immediately ahead, that sellers will again enter the market on a substantial scale.

As has been mentioned before, we feel there is an excellent chance that the bear market lows have been seen. However, until we can be more certain of this point discretion suggests that new commitments be confined to the bluer chip variety of merchandise or to situations such as the company covered in this month's letter where a strong earnings growth trend is likely to continue.

October 14, 1970.

— RECENT INVESTMENT SUGGESTIONS —

PREFERRED STOCKS				Dividend Rate	Current Call Price	Approx. Price	Yield
Bell Canada	\$3.20	Conv. ¹	\$ 47 par	\$3.20	N.C.	\$50.50	6.34%
Calgary Power	5.40%	Conv. ²	\$100 par	5.40	105.00	93.00	5.81
Hudson Bay Oil & Gas	5% A	Conv. ³	\$ 50 par	2.50	N.C.	54.00	4.63

¹Convertible share for share to Feb. 1982

²Convertible into 3-2/3 shares to Nov. 30, 1971

³Convertible into 1.2 shares to Oct. 15, 1972

COMMON STOCKS	Latest Earnings	12 Months Ended	Indicated Dividend	Approx. Price	Yield
Alcan Aluminum Limited	2.74 U.S.	June 70	1.20 U.S.	21.75	5.63%
Canadian Hydrocarbons	1.07	June 70	0.20	15.87	1.26
Canadian Tire "A"	0.83	June 70	0.20	22.87	.87
Dominion Glass Company	1.00	June 70	0.10	13.00	.77
Domtar Limited	1.31	June 70	0.70	13.62	5.14
Falconbridge Nickel	9.07	June 70	3.50	147.50	2.37
General Distributors	0.64	July 70	—	11.25	—
Loblaws Companies "B"	0.54	Mar. 70	0.38	6.00	6.33
Maher Shoes	2.57	July 70	0.72	21.50	3.35
Newconex Holdings	0.36	June 70	0.15	6.25	2.40
Scott's Restaurants Co. Ltd.	0.51	July 70	—	8.75	—
Standard Broadcasting	0.45	June 70	0.24	10.75	2.23